



In the Matter of:

Docket No. 04-IEP-1E, Achieving the
Preferred Loading Order White Paper

04-DIST-GEN-1 Order Instituting
Investigation on Exploring Issues
Associated with Implementation and
Distribution Planning of Distributed
Generation.

04-IEP-1

DOCKET

04-DIST-GEN-1

DATE MAY 12 2005

RECD MAY 16 2005

**Subject: 2005 Energy Report-CHP Workshop April 28, 2005 - Post Workshop
Comments regarding the Preparation of the 2005 Integrated Energy
Policy Report**

Thank you for this opportunity to provide comment from Capstone Turbine Corporation on the Workshop held on April 28 concerning the Preparation of the 2005 Integrated Energy Policy Report. Our comments here are focused very much on what we have seen in the market place to be the key problem in getting more DG/CHP deployed and what we believe is the next bold move required to significantly accelerate the deployment of DG.

In essence, we believe that most electricity users are largely content with having their power needs met by their local utility and that utilities are uniquely positioned to meet consumers' power needs in most cases. Therefore, we believe that utilities should be a major channel to achieve the State's policy goals with respect to the deployment of CHP and that the utilities should be directly involved in the deployment of CHP systems. We propose that, in order to bring utilities into the process of increasing the deployment of CHP consistent with State policy, a new requirement be established whereby utilities would have to increase the proportion of power they generate or procure from CHP systems by 20 percentage points over the next 10 years.

The growing body of evidence indicates that businesses are reluctant to install DG/CHP. Capstone's own survey of potential DG customers supports EPRI's finding as to why people consider using DG and, more importantly, why the vast majority (nearly 90%) do not consider DG a reasonable option. A lot of what the surveys tell us is that for most companies, electricity is simply not a priority issue. There are a number of reasons the surveys point us to that attempt to explain why companies do not consider energy an important issue for them despite recent supply issues and evidence of increasing difficulties with reliability. Fundamentally, though, most businesses believe that the utilities meet their needs for electricity better than they believe DG can meet those needs. The advantage that the utilities offer arises from not merely power quality and reliability

but more importantly from the commercial arrangements that surround the supply of power. In particular,

1. Electricity is a core competency of utilities whereas it's not a core competency of most businesses.
2. Utilities enable businesses to continue to outsource their power needs while DG may not. In today's business environment outsourcing is common practice. Asking businesses to self-generate runs against that major component of commercial activity,
3. Utilities can use their large customer base and diverse power sources to spread the risks of power supply while a DG user must directly bear most of the risks of its power supply. Moreover, the utility can sell power to end users at the average cost of its sources of power or the average of its distribution costs whereas the DG user must pay the full marginal cost.
4. The utilities can supply power to businesses without requiring long-term contracts. Utilities have huge balance sheets and large customer base built upon a legacy of the decades of protected vertically integrated monopoly franchises. They can spread their commercial risks and costs over their huge balance sheets and customer base without requiring long-term commitments from customers.
5. The utilities operations are supported with an implicit government guarantee, which mitigates the risk of supplying customers' with power and which is not available to any other power supply including self generation. This implicit guarantee was manifested in the aftermath of the California electricity crisis when the California Public Utilities Commission approved historic cost recovery charges, bond cost charges and departing load charges that were intended to ensure the utilities fully recovered the costs they incurred during the energy crisis. No DG supplier has that advantage.

The legacy of support provided to utilities in the form of decades of exclusive franchise operations has created organizations with financial stability, respect from the community and an omnipresence that gives them a significant advantage in perceptions in the market place.

The enormous ability of local utilities to meet the needs of customers is a huge hurdle for DG and CHP to overcome. We see how overwhelming that hurdle is in California where despite significant incentives, exemptions from certain utility charges, streamlined interconnection, support from government agencies and encouragement from utilities, little new DG has been added. Capstone knows from its experience in the market place that many businesses will not adopt DG/CHP even when the economics are very positive because they are very comfortable with the utility product. Additionally, for many of these businesses, energy costs are a small part of their total costs so getting them excited about DG/CHP even when there are great savings, is of little overall consequences to their business.

In sum, one of the biggest hurdles to address if we as a State are to deploy more DG is to provide a business model whereby DG/CHP can meet all the commercial advantages that the utility provides customers while also delivering the benefits of CHP.

Capstone believes that utilities are a highly effective means of providing that business model and that the utilities, which are to a large degree a product of government policy and regulation, should be used by government and regulators to implement their policy of advancing CHP/DG. We believe using utilities to effect government policy in favor of CHP will be a more effective approach to achieving the goals of policy than an alternative approach of trying to change the reality that exists today of dominant utilities.

Capstone's specific proposal is to add to the utilities procurement procedure a requirement that, by 2015, utilities increase the proportion of power they source from CHP systems by 20 percentage points and that they achieve this through a mix of direct and third party ownership as necessary to achieve the goal.

We believe that utility ownership of CHP systems will also effectively address the issues that are highlighted in EPRI's work, which seeks to find win-win situations for DG. If the utility owns and operated the CHP system, then it directly receives the benefits, which will go to offset any utility costs of the sort identified in the various scenarios reported by EPRI¹.

Dated on May 12, 2005

A handwritten signature in black ink, appearing to read "K. Duggan", with a stylized flourish at the end.

Kevin Duggan
Director, Government Affairs

¹ "Assessment of California CHP Market and Policy Options for Increased Penetration", Draft Report, April 2005, Prepared by EPRI, page 4-15 through 4-23